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TO AMEMBASSY OTTAWA PRIORITY

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TAGS: ENRG, CAN

SUBJECT: PROPOSAL FOR EXPANSION OF CRUDE OIL EXCHANGES

1. THE DEPARTMENT (EB/ORF/FSE) PROVIDED THE CANADIAN EMBASSY ON OCTOBER 1 WITH A PROPOSAL FOR EXPANSION OF CRUDE OIL EXCHANGE ARRANGEMENTS. THE PROPOSAL IS INTENDED TO SERVE AS THE STARTING POINT FOR DISCUSSIONS DURING THE OCTOBER 8 ENERGY CONSULTATIONS. THE FOLLOWING IS THE TEXT OF THE PROPOSAL.

2. BEGIN TEXT: PROPOSAL FOR EXPANSION OF CRUDE OIL EXCHANGES WITH CANADA

CANADA'S DECISION TO PHASE OUT CRUDE OIL EXPORTS TO THE UNITED STATES BY 1982 HAS CREATED A NUMBER OF SERIOUS SUP-
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PLY PROBLEMS FOR US REFINERS AND OTHER IMPORTERS OF

VARIOUS TYPES OF CRUDE OIL FROM CANADA, PARTICULARLY THOSE LOCATED IN NORTHERN TIER STATES WHICH HAVE BECOME DEPENDENT ON IMPORTS FROM CANADA AND CURRENTLY HAVE NO ALTERNATIVES TO CONTINUED RELIANCE ON IMPORTS FROM CANADA. THE MOST SERIOUS DIFFICULTY IS THAT MANY OF THESE US IMPORTERS OF CANADIAN CRUDE OIL DO NOT HAVE ACCESS TO ALTERNATIVE SOURCES OF SUPPLY NOR THE MEANS TO TRANSPORT REPLACEMENT SUPPLIES TO THEIR REFINERIES.

THE UNITED STATES GOVERNMENT ATTACHES VERY HIGH PRIORITY TO DEVELOPMENT OF ALTERNATIVE MEANS FOR SUPPLYING THESE CANADIAN-DEPENDENT REFINERIES. US FIRMS ARE CURRENTLY CONSIDERING A NUMBER OF ALTERNATIVES WHICH WOULD ENSURE THE SUPPLY OF NON-CANADIAN CRUDE OIL OVER THE LONG TERM. THESE INCLUDE: CONSTRUCTION OF NEW PIPELINE FACILITIES FROM KITIMAT, BRITISH COLUMBIA TO EDMONTON, ALBERTA; CONSTRUCTION OF A NORTHERN TIER PIPELINE FROM THE PUGET SOUND TO MINNESOTA; AND EXPANSION OF THE WILLIAMS BROTHERS PIPELINE SYSTEM. HOWEVER, EVEN ASSUMING A RAPID DECISION ON ONE OR MORE OF THESE PROJECTS, THE MOST EXPEDITIOUS PROCESSING AND APPROVAL OF THE NECESSARY APPLICATION AND NO CONSTRUCTION DELAYS, SUCH A LONG TERM SUPPLY ALTERNATIVE SYSTEM COULD NOT BE OPERATIONAL UNTIL LATE 1979. IN THE INTERIM, CANADIAN-DEPENDENT REFINERIES WILL FACE A GROWING SHORTAGE OF CRUDE OIL SUPPLIES BEGINNING IN 1977.

A JOINT US-CANADIAN WORKING GROUP RECOMMENDED IN JUNE 1975 THAT EXCHANGES OF OIL BETWEEN US AND CANADIAN REFINERIES WOULD BE HELPFUL IN ALLEVIATING THE IMPACT OF THE PHASE-OUT OF CANADIAN CRUDE OIL EXPORTS AND PROVIDE ECONOMIC BENEFITS TO BOTH COUNTRIES. FOR THIS REASON, BOTH GOVERNMENTS AGREED TO FACILITATE SUCH EXCHANGES WHICH WERE CONSISTENT WITH BROADER ENERGY POLICY OBJECTIVES.

HOWEVER, CANADA HAS REQUIRED THAT US-ORIGIN CRUDE OIL BE PROVIDED IN EXCHANGE FOR CANADIAN CRUDE. THIS REQUIREMENT CREATES TWO SERIOUS PROBLEMS FOR US REFINERS. FIRST, BECAUSE OF ESTABLISHED PRODUCER/SUPPLIER RELATION-LIMITED OFFICIAL USE

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SHIPS AND THE GROWING PROPORTION THAT IMPORTS REPRESENT OF US SUPPLY, IT IS DIFFICULT FOR CANADIAN-DEPENDENT REFINERS TO OBTAIN ACCESS TO US-ORIGIN OIL FOR USE IN EXCHANGES. SECOND, AND MORE IMPORTANTLY, IT NOW APPEARS THAT THERE IS INSUFFICIENT PIPELINE CAPACITY TO PERMIT THE MOVEMENT OF US-ORIGIN EXCHANGE OIL TO CANADA FROM CONVENTIONAL PRODUCING AREAS IN THE US. (EXISTING PIPELINES FROM THE GULF OF MEXICO TO THE CHICAGO AREA

ARE ALREADY FILLED BY NORMAL OIL MOVEMENTS AND OIL MOVING NORTH TO REPLACE CANADIAN SUPPLIES WHICH HAVE BEEN CURTAILED. THUS, US CANADIAN-DEPENDENT REFINERS SEEKING PIPELINE SPACE FOR MOVEMENT OF THE 13,000 B/D OF OIL UNDER EXCHANGE ARRANGEMENTS WHICH HAVE BEEN APPROVED BY BOTH GOVERNMENTS ARE EXPERIENCING DIFFICULTIES IN OBTAINING SPACE IN THESE LINES TO MOVE THIS OIL.)

IT NOW APPEARS THAT SUCH PIPELINE CONSTRAINTS COULD LIMIT EXCHANGES INVOLVING US-ORIGIN CRUDE TO A MAXIMUM OF 50,000 B/D. THIS LEVEL IS WELL BELOW THE FORECAST SHORTFALL IN SUPPLIES FOR NORTHERN TIER REFINERIES, WHICH HAS BEEN ESTIMATED AT MORE THAN 250,000 B/D OVER THE NEXT FOUR YEARS, BEFORE ALTERNATIVE SUPPLY FACILITIES ARE IN PLACE.

EXPANSION OF THE PARAMETERS FOR EXCHANGES TO ALLOW THE US OF US-OWNED OFFSHORE OIL WOULD PERMIT THE USE OF SURPLUS PIPELINE CAPACITY IN THE PORTLAND-MONTREAL SYSTEM, THUS PROVIDING MORE ASSURANCE TO NORTHERN TIER REFINERIES AND THE REGION THEY SERVE OF CONTINUING ENERGY SUPPLIES UNTIL LONG-TERM SUPPLY FACILITIES ARE IN PLACE.

THE US GOVERNMENT WOULD WELCOME THE VIEWS OF THE GOVERNMENT OF CANADA ON EXPANSION OF THE PARAMETERS FOR OIL EXCHANGES, PARTICULARLY CONCERNING THE USE OF US-OWNED OFFSHORE OIL IN SUCH EXCHANGES. THE US ENVISIONS THAT EXCHANGES BETWEEN COMMERCIAL FIRMS INVOLVING OFFSHORE OIL WOULD BE NEGOTIATED WITHIN THE FOLLOWING GENERAL GUIDELINES:

-- TOTAL EXCHANGE VOLUME WOULD NOT EXCEED THE EXPECTED SHORTFALL IN OIL SUPPLIES BY LIMITED OFFICIAL USE

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CANADIAN-DEPENDENT REFINERIES.

-- EXCHANGES WOULD BE LIMITED IN TIME TO AN INTERIM PERIOD DURING WHICH LONG-TERM SUPPLY FACILITIES TO MEET THE NEEDS OF THESE REFINERIES ARE BEING COMPLETED.

-- IN RECOGNITION OF CANADA'S DESIRE TO ASSURE ITSELF OF THE SECURITY OF ITS OIL SUPPLY, THE OBLIGATION TO EXCHANGE CANADIAN OIL WOULD NOT BECOME EFFECTIVE UNTIL OFFSHORE OIL IS LAID DOWN IN LOCATIONS WHICH WILL ASSURE THEIR DELIVERY TO CANADIAN REFINERIES, E.G. PLACED IN BOND AT PORTLAND, MAINE OR LAID DOWN AT A TRANS SHIPMENT TERMINAL IN CANADA.

-- TOTAL CANADIAN OIL PRODUCTION WILL NOT BE INCREASED AS A RESULT OF SUCH EXCHANGES, HOW-

EVER, CANADA WOULD NOT COUNT OIL EXPORTED TO
THE US PURSUANT TO SUCH EXCHANGE ARRANGEMENTS
AGAINST THE LIMIT ON EXPORTS ESTABLISHED BY
THE GOVERNMENT OF CANADA.

-- EXCHANGE ARRANGEMENTS WOULD CONTINUE TO BE
NEGOTIATED BETWEEN US AND CANADIAN PRIVATE
COMPANIES. THE ROLE OF THE US AND CANADIAN
GOVERNMENTS WILL BE LIMITED TO FACILITATION
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OF SUCH ARRANGEMENTS AND APPROVAL OF
APPLICATIONS BY FIRMS IN THEIR RESPECTIVE
COUNTRIES.

THE US GOVERNMENT IS PREPARED TO DISCUSS OTHER
ARRANGEMENTS WHICH MIGHT BE NECESSARY. END TEXT. KISSINGER

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